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## USTR Talks Tough In Tokyo

U.S. Trade Representative Clayton Yeutter's first trip to Japan has produced several new developments in the administration's attempts to resolve U.S.-Japan trade frictions. In straightforward sessions with Japanese leaders, Mr. Yeutter described an administration determined to combat unfair trade practices and a Congress on the rampage against all U.S. trading partners, but

Most news accounts postulate that trade tactics will be decided by White House Chief of Staff Donald T. Regan, who has a reputation as a free trader but is said to be sensitive to the administration's relations with Hill Republicans. Some of the strongest calls for retaliation against Japan and other trade partners are coming from the GOP. Partisan struggles over control of the issue are almost as colorful as the White House-Capitol Hill battle. Punitive action against shoe exporters could mean triumph over the Democrats on a potential campaign issue, as well as the re-establishment of party discipline.

Overall, the administration's smoke signals to Congress have increased in number in recent weeks. Along with leaks about the footwear case, there are reports of an "action program" in the fall that will include liberal use of presidential veto powers on a variety of legislative initiatives, including trade. Similarly, USTR Yeutter's straight talk during his trip to Tokyo, although principally aimed at Japanese officials, was meant to portray a newly aggressive administration as well (see article in this issue.)

Part of that aggressiveness may stem from previous criticisms that the administration has lost interest or control over trade policy formation. It may also be seen as an indication of individual trade policy styles and/or an example of continued "get tough" tactics aimed at Japan and other U.S. trading partners. It is still too early to predict precisely the direction the administration's trade policy review will take. Trade watchers in Washington are, literally, waiting for the other shoe to drop.

Sheri Hoptman

## Rising Trade Deficit Exerting Less Drag On U.S. Growth

Reagan administration economic forecasters have come under fire from their private-sector colleagues for being too bullish about overall U.S. growth prospects in 1985, but no one can fault them for glossing over the likelihood of another big jump in this country's already yawning merchandise trade deficit. At the start of the year, government trade analysts predicted that the imbalance would be $25 to $30 billion above 1984's $123.3 billion red-ink entry (imports valued c.i.f.). Although this is one projection the White House would be happy to see proved wrong, forecasters have so far been on target.

At $69.3 billion through June ($61 billion using Customs value imports), the U.S. trade deficit was already $10.5 billion ($9.7 billion) bigger than in the first half of 1984. Exports were up for the six months but only by 1.6 percent to $110.5 billion. More ominously, overseas sales slipped 1.1 percent in the second quarter after expanding 4.4 percent during the January-March period, pulled down by a drop in shipments of industrial supplies and food and feed commodities to Japan. At the same time, though, imports expanded at a much more moderate rate than last year, rising 7.3 percent to $179.7 billion (7.1 percent to $171.5 billion on a Customs basis) in 1985's first half. There was some pickup in the growth of purchases from abroad during the April-June quarter -- paradoxically, from countries other than Japan, but not enough to force analysts to revise their projections of modest import gains this year.

## U.S. Exports to Japan

(in millions of dollars, f.a.s. value basis)

| | January-June 1984 | January-June 1985 | Percent Change |
|---|---|---|---|
| Total Exports | $11,584.7 | $11,550.1 | -0.3% |
| Industrial Supplies | 4,478.3 | 4,449.5 | -0.6 |
| Bituminous Coal | 500.1 | 418.7 | -16.3 |
| Petroleum Products | 291.9 | 392.8 | 34.6 |
| Natural Gas | 124.0 | 115.0 | -7.3 |
| Nuclear Fuels | 83.4 | 55.9 | -33.0 |
| Logs and Lumber | 451.9 | 430.8 | -4.7 |
| Paper Base Stocks | 266.7 | 242.8 | -9.0 |
| Paper and Paper Products | 154.5 | 140.5 | -9.1 |
| Organic Chemicals | 360.4 | 354.3 | -1.7 |
| Inorganic Chemicals | 298.0 | 401.8 | 34.8 |
| Plastics and Synthetic Resin Compounds | 178.6 | 156.7 | -12.3 |
| Fertilizers and Insecticides | 139.5 | 146.8 | 5.2 |
| Steel Scrap | 136.5 | 97.2 | -28.8 |
| Nonferrous Ores and Scrap | 180.1 | 227.7 | 26.4 |
| Nonferrous Metals | 217.0 | 167.2 | -22.9 |
| Textiles | 55.7 | 61.3 | 10.1 |
| Raw Cotton | 358.6 | 269.3 | -24.9 |
| Hides and Skins | 166.2 | 136.4 | -17.9 |
| Leaf Tobacco | 40.0 | 83.4 | 108.5 |
| Capital Goods | 2,774.4 | 3,223.0 | 16.2 |
| Nonelectric Machinery | 1,671.2 | 1,828.8 | 9.4 |
| Data Processing Equipment | 519.2 | 731.3 | 40.9 |
| Measuring, Testing and Control Instruments | 214.1 | 244.8 | 14.3 |
| Laboratory Testing and Control Instruments | 45.3 | 57.4 | 26.7 |
| Scientific, Professional and Medical Equipment | 125.3 | 138.3 | 10.4 |
| Power Generating Equipment (excl. aircraft and automotive engines) | 214.6 | 40.5 | -81.1 |
| Metalworking Equipment | 47.0 | 56.3 | 19.8 |
| Service Industry Equipment | 54.5 | 61.1 | 12.1 |
| Electric Machinery | 439.5 | 433.9 | -1.3 |
| Generators and Transformers | 55.3 | 37.5 | -32.2 |
| Broadcast and Communications Equipment | 220.4 | 179.0 | -18.8 |
| Telephonic and Other Electric Equipment | 163.9 | 217.5 | 32.7 |
| Transportation Equipment | 663.7 | 960.3 | 44.7 |
| Civilian Aircraft | 255.4 | 542.0 | 112.2 |
| Civilian Aircraft Engines and Parts | 239.5 | 276.7 | 15.5 |
| Automotive Parts | 87.9 | 98.1 | 11.6 |
| Food and Feed | 2,982.3 | 2,306.6 | -22.7 |
| Corn | 1,107.7 | 686.0 | -38.1 |
| Sorghum | 109.9 | 105.4 | -4.1 |
| Soybeans | 639.7 | 466.1 | -27.1 |
| Wheat | 243.1 | 226.8 | -6.7 |

| | | | |
|---|---|---|---|
| Fruits and Vegetables | 245.3 | 244.4 | -0.4 |
| Meat and Meat Products | 301.1 | 255.6 | -15.1 |
| Fish and Fish Products | 136.9 | 145.3 | 6.1 |
| Consumer Goods | 721.8 | 737.8 | 2.2 |
| Pharmaceuticals | 270.5 | 310.4 | 14.8 |
| Toys and Sporting Goods | 48.6 | 43.4 | -10.7 |
| Cigarettes | 49.0 | 40.3 | -17.8 |

U.S. Imports from Japan

(in millions of dollars, Customs value basis)

| | January-June 1984 | January-June 1985 | Percent Change |
|---|---|---|---|
| Total Imports | $27,037.5 | $33,967.8 | 25.6% |
| Automotive Products | 9,019.4 | 11,743.6 | 30.2 |
| Cars | 6,017.9 | 7,488.3 | 24.4 |
| Assembled Trucks | 1,333.7 | 2,031.1 | 52.3 |
| Automotive Parts | 1,629.5 | 1,919.1 | 17.8 |
| Capital Goods | 8,899.8 | 10,967.8 | 23.2 |
| Nonelectric Machinery | 6,016.4 | 7,418.1 | 23.3 |
| Business Machines | 3,064.5 | 3,303.1 | 7.8 |
| Metalworking Machinery | 394.2 | 630.9 | 60.0 |
| Agricultural Machinery | 176.2 | 192.4 | 9.2 |
| Specialized Industrial Machinery | 639.9 | 631.7 | -1.3 |
| Scientific, Professional and Medical Equipment | 225.6 | 292.3 | 29.6 |
| Electric Machinery | 2,739.4 | 3,375.4 | 23.2 |
| Transportation Equipment | 144.0 | 174.3 | 21.0 |
| Consumer Goods | 5,184.7 | 6,908.5 | 33.2 |
| Video and Audio Recorders and Players and Stereo Equipment | 1,639.0 | 2,662.3 | 62.4 |
| Television Sets | 306.9 | 376.4 | 22.6 |
| Radio Receivers | 138.6 | 157.9 | 13.9 |
| Tableware and Glassware | 187.6 | 206.9 | 10.3 |
| Metal Cookware and Cutlery | 181.8 | 190.1 | 4.6 |
| Photographic and Optical Goods | 476.3 | 470.0 | -1.3 |
| Clocks and Watches | 182.7 | 230.3 | 26.1 |
| Toys and Sporting Goods | 198.0 | 264.9 | 33.8 |
| Motorcycles and Parts | 391.8 | 472.0 | 20.5 |
| Clothing | 233.9 | 238.0 | 1.8 |
| Intermediate Goods | 3,532.1 | 3,752.4 | 6.2 |
| Steel Mill Products | 1,458.5 | 1,731.6 | 18.7 |
| Nonferrous Metals | 265.8 | 263.3 | -0.9 |
| Organic Chemicals | 251.5 | 298.3 | 18.6 |
| Tires and Tubes | 268.5 | 283.9 | 5.7 |
| Textiles | 337.3 | 358.7 | 6.3 |

Although deeper in the red in the April-June period, the trade deficit was far less of a drag on U.S. economic expansion than in 1985's first three months. Worsening trade results shaved 4.2 percentage points off the growth of inflation-adjusted gross national product during that quarter, limiting the rise to just 0.3 percent. In comparison, the deteriorating U.S. trade position cut the gain in real GNP during the April-June period by 1.3 percentage points or from 3.3 percent to 2 percent.

Forecasters generally expect the widening trade gap to take a reduced toll on the U.S. economy during the last two quarters of 1985 even as the imbalance moves toward the $150 billion mark for the year. Roughly one-third of this red ink will come from trade with Japan. The bilateral deficit already stands at $24.2 billion ($22.4 billion if imports are valued on a Customs basis), up from $17 billion ($15.5 billion) in the January-June 1984 period, and this figure could easily double by year-end, particularly if exports of industrial and agricultural inputs do not turn around quickly (see accompanying tables).

Susan MacKnight

Trends In Foreign Investment Income

By year-end, Japan will become the world's largest creditor nation while the United States will be the largest debtor country. Japan's 1984 net long-term capital outflow of $49.7 billion increased its net foreign assets to $74.3 billion (see JEI Report No. 26B, July 12, 1985) and Ministry of Finance officials expect that figure to top $100 billion by the end of 1985. At the same time, the United States lost its position as the world's preeminent creditor country following three years of large current account deficits and related net capital inflows. Sometime during the first half of 1985, the United States became a net debtor nation for the first time since 1914.

The long-run economic and political implications of this shift are uncertain. It is clear, however, that the changes in net asset positions will reduce the net investment income received by the United States while increasing Japan's, exacerbating the current account imbalances of each country.

As shown in the accompanying table, Japan's net investment income account went from an $0.8 billion deficit in 1981 to a $4.2 billion surplus in 1984. This $5 billion change in the balance was due to a $3 billion increase in income from abroad from 1981 to 1984 and a $2 billion drop in the amount paid to foreigners. Profits from direct investments, which amounted to $2.2 billion of Japan's total investment income of $18.8 billion in 1984, accounted for about one-fourth of the $3 billion rise, while interest on loans, portfolio investments and trade credits was responsible for the remaining three-fourths. This large expansion has contributed to the $30 billion increase in Japan's current account surplus during this period. The surplus on investment continued to expand in 1985, accounting for $3.5 billion of the huge current account surplus of $20 billion during the first six months of the year.

U.S. net investment income has fallen rapidly, reflecting the dissipation of America's net foreign asset position. In 1981, the $34.1

billion net investment income inflow more than offset the $28 billion merchandise trade deficit. In 1984, however, the investment income surplus was $19.1 billion, falling in the first quarter of 1985 to only $2.6 billion. This decline means that the United States can no longer maintain a balance on its current account while reporting a large merchandise trade deficit. Instead, the United States will have to achieve a balance in merchandise trade and business services if it is to balance its current account.

Randall S. Jones

Table 1: Selected Foreign Balances, Japan

(in billions of dollars)

| | 1981 | 1982 | 1983 | 1984 | IQ 1984 | IIQ 1984 | IQ 1985 | IIQ 1985 |
|---|---|---|---|---|---|---|---|---|
| Current Account | $4.8 | $6.8 | $20.8 | $35.0 | $4.8 | $10.0 | $6.8 | $13.3* |
| Merchandise Trade | 20.0 | 18.1 | 31.5 | 44.3 | 7.6 | 11.8 | 8.9 | 14.1* |
| Services | -13.6 | -9.8 | -9.1 | -7.7 | -2.2 | -1.5 | -1.6 | -0.6* |
| Investment Income | -0.8 | 1.7 | 3.1 | 4.2 | 0.8 | 1.4 | 1.3 | 2.2* |

*Preliminary

Source: Bank of Japan

Table 2: Selected Foreign Balances, United States

(in billions of dollars, seasonally adjusted)

| | 1981 | 1982 | 1983 | 1984 | IQ 1984 | IIQ 1984 | IQ 1985 | IIQ 1985 |
|---|---|---|---|---|---|---|---|---|
| Current Account | $6.3 | -$8.1 | -$40.8 | -$101.5 | -$19.1 | -$24.5 | -$30.0* | n.a. |
| Merchandise Trade | -28.0 | -36.4 | -62.0 | -108.3 | -25.6 | -25.7 | -29.4* | -33.4* |
| Services | 42.3 | 36.8 | 30.2 | 19.9 | 9.1 | 4.0 | 2.7* | n.a. |
| Investment Income | 34.1 | 29.5 | 25.4 | 19.1 | 8.2 | 3.6 | 2.6* | n.a. |

*Preliminary

Source: Department of Commerce

## IBM Interfaces With MITI's High Technology Patents

In debating the reasons for the rapid rise of the Japanese economy since the end of World War II, the close scientific cooperation between government and industry is often mentioned. The fruits of this cooperation, industrial patents, were in some cases jointly owned by the Japanese government and were licensed to Japanese companies for commercial use. Foreign access to these

Update On Japan's Venture Capital Industry

By all accounts, Japan's venture enterprises and venture capital firms are fulfilling their high-growth potential (see JEI Report No. 39A, October 12, 1984). According to a government survey, almost 20 percent of 863 venture businesses surveyed achieved at least 15 percent growth in 1984 and another 16 percent claimed growth of 40 percent or more. A leading economic journal reports that the number of venture firms has increased 40 percent since 1982 and similar growth is predicted for the next three years.

An annual survey by the Venture Enterprise Center, an independent agency of the Ministry of International Trade and Industry, shows that electronics remains the most popular area for Japanese venture entrepreneurs, accounting for 24 percent of all endeavors. Next are computer software companies (18.6 percent), robotics firms (16.4 percent), information and telecommunications services (10.9 percent), precision machinery makers (10.4 percent), new materials manufacturers (8.6 percent), energy firms (1.6 percent) and marketing concerns (1.5 percent). The VEC survey reveals that the average venture enterprise devotes more of its staff to research and development than the average small business -- 20 percent versus 5.8 percent -- and supplies them with more expensive equipment, spending an average of Y150 million ($625,000) per piece of equipment instead of the average Y32 million ($133,333). The agency forecasts a quadrupling of both sales and employment by venture businesses in the next five years.

Venture capital firms have kept pace with this furious growth, according to the VEC. The number of venture capital funds rose to 29 by the end of 1984, representing nearly Y89 billion ($371 million) in capital, up from 16 funds worth Y46 billion ($192 million) the previous year. Concurrently, the number of venture capital partners jumped from 323 to 615 between 1983 and 1984. Japanese venture investors continue to put most of their money into companies not listed on a major exchange (see Table 1). The popularity of warrants -- notes that grant an investor the right to purchase shares at a set price within a time limit in exchange for cash now -- and convertible bonds skyrocketed during 1984 thanks to a relaxation of regulatory procedures by the Ministry of Finance. The cumulative effects of the economic recovery and financial deregulation are apparent in the doubling of investments in 1984 over the year-earlier level.

Another encouraging trend brought out by the survey is the increasing flow of venture capital into the manufacturing sector (see Table 2). Although venture capitalists spent 72 percent more on non-manufacturing enterprises in 1984, manufacturing investments rose by 146 percent. As a consequence, this sector's share of the total value of investments rose from 53 percent to 58 percent. Its share of cases, however, declined one percentage point from 1983's level to 57 percent.

Despite these positive trends, Japanese venture enterprises still face significant difficulties. Although most funds are flowing to unlisted firms, these companies are relatively well-known and have an established track record. Very little venture capital (approximately 10 percent of all investments) is being used as seed money, meaning that entrepreneurs that possess only good ideas have a hard time translating them into reality. Rapid

growth poses new problems for entrepreneurs and some observers predict that a shakeout will occur in several sectors. This is already apparent in the computer industry where three very promising companies, including personal computer pioneer Sord Computer Corp., have either closed their doors or have been bought out in recent months.

Japanese venture capitalists remain weak-hearted in comparison with their American competitors as indicated by the paucity of high-risk investments. Venture capital funds linked to major banks or securities houses continue to approach the business with an eye toward developing new clients for their associated financial institutions. In addition, the lack of experience in evaluating the potential of entrepreneurs' proposals remains glaring.

The fact that venture businesses have performed superbly in spite of these problems reflects the relative immaturity of the industry. The traditional financial structure has been able to accommodate the needs of the nascent venture capital industry. If it is to mature, however, these deficiencies must be corrected.

Jon Choy

Table 1: Japanese Venture Capital Investments by Type

(year-end balance in number of cases and millions of yen)

| | 1983 | | 1984 | |
|---|---|---|---|---|
| | Cases | Value | Cases | Value |
| Investments by General Investors | | | | |
| Stocks | 500 | Y22,878 | 952 | Y43,776 |
| Listed Stocks | 63 | 2,344 | 82 | 4,067 |
| Unlisted Stocks | 437 | 20,534 | 870 | 39,709 |
| Warrants | 83 | 4,324 | 204 | 6,600 |
| Convertible Bonds | | | 90 | 4,286 |
| Total | 583 | 27,202 | 1,246 | 54,662 |
| Investments by Investor Partnerships | | | | |
| Stocks | 72 | 10,627 | 357 | 28,037 |
| Listed Stocks | 0 | 0 | 1 | 66 |
| Unlisted Stocks | 72 | 10,627 | 356 | 27,971 |
| Warrants | 10 | 405 | 29 | 786 |
| Convertible Bonds | | | 61 | 2,359 |
| Total | 82 | 11,032 | 447 | 31,182 |
| Total Investments | | | | |
| Stocks | 572 | 33,505 | 1,309 | 71,813 |
| Listed Stocks | 63 | 2,344 | 83 | 4,133 |
| Unlisted Stocks | 509 | 31,161 | 1,226 | 67,680 |
| Warrants | 93 | 4,729 | 233 | 7,386 |
| Convertible Bonds | | | 151 | 6,645 |
| Total | 665 | 38,234 | 1,693 | 85,844 |

Source: Venture Enterprise Center, Ministry of International Trade and Industry.

Table 2: Japanese Venture Capital Investments by Industry

(year-end balance in number of cases and millions of yen)

| Industry | 1983 Cases | 1983 Value | 1984 Cases | 1984 Value |
|---|---|---|---|---|
| Manufacturing | 387 | Y20,247 | 973 | Y49,906 |
| Food Products | 20 | 584 | 50 | 2,024 |
| Textiles | 3 | 90 | 4 | 105 |
| Apparel and Textile Products | 20 | 450 | 22 | 684 |
| Lumber and Wood Products | 3 | 34 | 7 | 154 |
| Household Articles and Furniture | 9 | 321 | 18 | 764 |
| Pulp and Paper | 1 | 27 | 11 | 957 |
| Printing and Publishing | 4 | 78 | 10 | 190 |
| Chemicals | 28 | 1,952 | 72 | 4,549 |
| Oil and Coal | 0 | 0 | 0 | 0 |
| Rubber Products | 4 | 84 | 5 | 84 |
| Leather and Leather Products | 1 | 30 | 1 | 30 |
| Glass and Cement | 6 | 129 | 14 | 579 |
| Steel | 1 | 15 | 1 | 15 |
| Nonferrous Metals | 0 | 0 | 12 | 479 |
| Metal Products | 11 | 260 | 31 | 1,239 |
| Nonelectric Machinery | 45 | 3,107 | 91 | 3,702 |
| Electric Machinery and Electronics | 130 | 8,005 | 345 | 19,518 |
| Transportation Machinery | 13 | 249 | 13 | 303 |
| Precision Machinery | 48 | 2,984 | 182 | 9,968 |
| Other Manufacturing | 40 | 1,848 | 84 | 4,562 |
| Services | 88 | 4,371 | 288 | 10,620 |
| Computer Software | 35 | 990 | 142 | 5,183 |
| Information Management | 6 | 284 | 35 | 1,365 |
| Data Bases | 4 | 45 | 15 | 345 |
| Other Information Services | 1 | 158 | 10 | 342 |
| Other Services | 42 | 2,894 | 86 | 3,385 |
| Distribution and Sales | 75 | 4,222 | 210 | 8,983 |
| Other | 104 | 8,267 | 186 | 13,473 |
| Restaurants | 7 | 103 | 16 | 351 |
| Construction | 19 | 484 | 41 | 1,507 |
| Finance | 49 | 6,156 | 75 | 8,351 |
| Transportation and Delivery | 3 | 113 | 4 | 118 |
| Real Estate | 13 | 699 | 4 | 473 |
| Other | 13 | 712 | 46 | 2,673 |
| Domestic Total | 654 | 37,107 | 1,657 | 82,982 |
| Foreign Investments | 11 | 1,127 | 36 | 2,862 |
| Overall Total | 665 | 38,234 | 1,693 | 85,844 |

Source: Venture Enterprise Center, Ministry of International Trade and Industry.